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No. 90-1918

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

KRAFT GENERAL FOODS, INC.,
Petitioner,

v.

IOWA DEPARTMENT OF REVENUE AND FINANCE,
Respondent.

On Writ of Certiorari to the Supreme Court of Iowa

BRIEF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL GOVERNORS' ASSOCIATION, COUNCIL OF STATE GOVERNMENTS, NATIONAL ASSOCIATION OF COUNTIES, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, NATIONAL LEAGUE OF CITIES, AND U.S. CONFERENCE OF MAYORS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether Iowa's unitary method of taxing corporate income facially violates the Foreign Commerce Clause because the Iowa statute uses the Internal Revenue Code's definition of taxable income to determine its tax base.

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INTEREST OF THE *AMICI CURIAE*

Amici, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments, including questions of state taxing authority. Reversal of the judgment below would both cripple the States' efforts to collect taxes from multinational corporations and undermine the States' at-

tempts to simplify state tax collection and payment through the use of federal standards for taxable income. *Amici* accordingly submit this brief to assist the Court in its resolution of this case.[1]

STATEMENT OF THE CASE

1. Iowa's treatment of foreign dividends is identical in all relevant respects to the Vermont taxing scheme this Court sustained against a Foreign Commerce Clause challenge in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980).[2] Iowa, like Vermont, uses federal "taxable income" as the basis for calculating corporate "net income" subject to state income tax. *See* Iowa Code § 422.35 (defining "net income" as "taxable income . . . as properly computed for federal income tax purposes under the Internal Revenue Code").

Under the Internal Revenue Code, a corporation that owns at least 80% of the stock of another "domestic" corporation subject to federal income tax may deduct 100% of the dividends received from that corporation.[3] 26 U.S.C. § 243. Such domestic subsidiary dividends are, therefore, excluded from federal income tax. The purpose of the federal exclusion is to protect taxpayers from being taxed twice on the same activity. Congress determined that it did not

[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of the Court.

[2] Kraft concedes that the Iowa and Vermont tax schemes affect foreign commerce "in identical fashion." *See* Pet. Br. 8-9 & n.11.

[3] A domestic corporation, in this context, is defined as one organized under the law of the United States or of any State. 26 U.S.C. § 7701(a)(4).

wish to tax a parent on dividends received from a subsidiary whose income the federal government has already taxed. *See* H.R. Rep. No. 708, 72d Cong., 1st Sess. 12 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 16 (1932).

This double taxation problem does not exist with regard to dividends paid to U.S. corporations by their foreign subsidiaries, *i.e.*, subsidiaries organized and doing business exclusively abroad, since the foreign subsidiaries' income is not subject to federal income tax. Consequently, the federal tax code does not allow a domestic corporation to deduct from taxable income the dividends that it receives from its foreign subsidiaries.[4]

As noted above, Iowa adopts the federal definition of "taxable income." As a result, Iowa's preapportionment tax base, like the federal tax system, includes dividends paid by foreign subsidiaries but not dividends paid by domestic subsidiaries.[5]

[4] The Internal Revenue Code does, however, allow a corporate taxpayer to elect either to deduct foreign income taxes it has paid on its foreign operations (26 U.S.C. § 164(a)(3)) or to take a tax credit based on the foreign income taxes it has paid and the foreign income taxes the foreign corporation has paid (26 U.S.C. §§ 901-902).

[5] This does not mean, however, that a state tax system like Iowa's does not tax domestic dividends. By taxing an apportioned share of the income out of which such dividends are paid, the Iowa system captures the value that the domestic subsidiary contributes to the unitary business. Under this system, some State will have the opportunity to apportion and tax the domestic subsidiary's income no matter where in the United States it does business; but since the income of foreign subsidiaries is not taxable, no State will ever tax more than its apportioned share of the dividends paid by the foreign subsidiary.

2. In 1981 Kraft owned over 80% of the stock of six foreign subsidiaries that were part of its unitary business and that conducted their activities outside the United States. These six subsidiaries paid Kraft dividends of approximately $10 million, all of which was earned from their foreign operations. It is undisputed that the dividends were part of Kraft's unitary business income. *See* Pet. App. 33a, 53a. The foreign countries in which the subsidiaries operated imposed withholding taxes of approximately $1.5 million on the dividends, *id.*, and the earnings from which the dividends were paid were subject to foreign income tax. *Id.* at 12a.

Kraft included these foreign subsidiary dividends in calculating its federal taxable income for 1981. In calculating its 1981 Iowa income tax, however, Kraft deducted these foreign subsidiary dividends from its federal "taxable income." Respondent Iowa Department of Revenue and Finance assessed additional taxes against Kraft for its failure to include foreign subsidiary income in its Iowa tax base, and these proceedings followed.

SUMMARY OF ARGUMENT

1. Kraft's claim that the Iowa tax statute facially violates the Foreign Commerce Clause fails at the outset because there is nothing discriminatory about Iowa's tax scheme. " 'A facial challenge to a legislative Act is, of course, the most difficult challenge to mount successfully, since the challenger must establish that no set of circumstances exists under which the Act would be valid.' " *Rust v. Sullivan*, 111 S. Ct. 1759, 1767 (1991) (citation omitted). Kraft's burden is to show that the Iowa tax, " 'on its face, [was] designed to have discriminatory economic effects.' "

Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66, 75 (1989) (citation omitted). The question whether a state tax facially discriminates against foreign commerce by its treatment of the tax obligations of a unitary business obviously can be answered only by considering the overall effect of the tax on the income of the unitary business. Kraft makes no such showing. It relies instead upon conclusory generalizations and hypotheticals that misleadingly isolate Iowa's differential treatment of dividends but purposely disregard the impact of Iowa's unitary tax system on Kraft's unitary income.

2. Even if the Court concludes that it is appropriate to analyze in isolation Iowa's treatment of subsidiary dividends, the statute comports with the Foreign Commerce Clause. That Clause is not violated unless in-state business is advantaged as a result of the allegedly discriminatory state tax. A state tax law does not violate the Foreign Commerce Clause merely because it may, under some circumstances, advantage domestic business over foreign business, particularly where, as here, the State has acted in a manner consistent with national policy by expressly incorporating provisions of federal tax law. "[T]he dormant Commerce Clause, in both its interstate and foreign incarnations, only operates where the Federal Government has not spoken to ensure that the essential attributes of nationhood will not be jeopardized by States acting as independent economic actors." *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1, 12 (1986). Its constraints on state taxing authority have no application here.

ARGUMENT

I. THE IOWA TAX STATUTE DOES NOT FACIALLY DISCRIMINATE AGAINST FOREIGN COMMERCE

We emphasize at the outset the narrowness of the determination the Court is called upon to make in this case. First, it is settled that Iowa has the power to tax its apportioned share of the dividend income that Kraft receives from its foreign subsidiaries since these dividends are a component of a unitary business that is conducted in Iowa. *See Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). Here, as in *Mobil*, the taxpayer's "quarrel [is] with the calculation of the tax base and not with the method or accuracy of the statutory apportionment formula." *Id.* at 433. *Mobil* establishes that the dividends a foreign subsidiary pays a parent in a unitary business are no different for the purposes of determining the tax base than any other operating income. *Id.* at 440.

Second, it is likewise settled that in taxing values which a foreign subsidiary contributes to a unitary business, States may go far beyond Iowa's conservative practice of merely including foreign subsidiary dividends in state "taxable income." In *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court upheld, as consistent with the Foreign Commerce Clause, California's far more inclusive "combined" reporting tax scheme, which disregards the separate corporate form of foreign and domestic entities engaged in a unitary business, and allowed the State to include in the corporate tax base the entire net income generated abroad by the foreign subsidiaries of the unitary business. *See id.* at 168 & n.5.[6]

[6] Such a combined apportionment approach includes income of subsidiaries and affiliates in the parent's net income but disregards all intercorporate transfers, such as a parent's receipt of dividends. *See Mobil*, 445 U.S. at 441 n.15.

Third, Kraft concedes that the Iowa tax is valid under the inquiries that are unique to Foreign Commerce Clause analysis. The four-part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), is applicable in like fashion to both interstate and foreign commerce. *See Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 444-45 (1979) (quoting *Complete Auto*, 430 U.S. at 279). In Foreign Commerce Clause tax cases, two additional inquiries may be undertaken:

> [F]irst, whether the tax . . . creates a substantial risk of international multiple taxation, and second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments."

Japan Line, 441 U.S. at 451.[7] The Court has already rejected a corporate taxpayer's argument that a state tax scheme just like Iowa's "prevents the Nation from speaking with a single voice in foreign commercial affairs." *Mobil*, 445 U.S. at 436. Kraft has expressly limited its challenge to the contention, based on *Complete Auto*, that the Iowa tax "discriminates" against foreign commerce. Pet. Br. 14.

[7] *Japan Line* involved "ad valorem property taxes assessed directly upon instrumentalities of foreign commerce." *Mobil*, 445 U.S. at 448. As the Court observed in *Mobil*, "the factors favoring use of the allocation method in property taxation have no immediate applicability to an income tax." *Id.* This is because income taxes affect equally all unitary businesses doing business in a State whether their owners are foreign or domestic, which is not necessarily true when taxes are imposed on tangible personal property, such as the cargo containers in *Japan Line*.

Finally, and most importantly, while there are three possible grounds for discrimination challenges to state taxes under the Commerce Clause,[8] Kraft argues only that Iowa's tax is "facially" discriminatory. Kraft does not allege that Iowa adopted the federal definition of taxable income because it intended to discriminate against foreign commerce. Nor has Kraft argued—or presented any evidence that would demonstrate—that the Iowa taxing system has the effect of unduly burdening commerce.

A. Kraft Cannot Prevail In This Facial Challenge to the Iowa Statute Because It Cannot Show That the Statute Was Designed to Have Discriminatory Effects

As the Court has recently reiterated, " '[a] facial challenge to a legislative Act is, of course, the most difficult challenge to mount successfully, since the challenger must establish that no set of circumstances exists under which the Act would be valid.' " *Rust v. Sullivan*, 111 S. Ct. 1759, 1767 (1991) (quoting *United States v. Salerno*, 481 U.S. 739, 745 (1987)). In this case Kraft must establish that the Iowa tax " 'on its face, [was] designed to have discriminatory economic effects' and thus [is] invalid under the Commerce Clause." *Amerada Hess Corp.*, 490 U.S. at 75 (quoting *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406-07 (1984)).[9] *See also id.* at 76 (a tax

[8] The taxpayer may challenge a tax on the grounds that it "is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce." *See Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66, 75 (1989) (citation omitted).

[9] Kraft bears the burden of establishing the statute's unconstitutionality. *See Container Corp.*, 463 U.S. at 175 (internal quotations omitted); *Norton Co. v. Department of Revenue*, 340 U.S. 534, 537 (1951).

is "not facially discriminatory" if "there is no explicit discriminatory design to the tax"). In analyzing statutory discrimination alleged to violate the Commerce Clause, the "principal focus of inquiry must be the practical operation of the statute, since the validity of state laws must be judged chiefly in terms of their probable effects." *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 37 (1980) (collecting cases).

The exclusive reliance by Kraft and its *amici* on conclusory assertions and a few hypotheticals that totally ignore the impact of the Iowa system on taxation of unitary income is patently insufficient to meet Kraft's burden of establishing that the Iowa system on its face is designed to have discriminatory effects.[10] *Amici* Avon Products, for example, baldly asserts that "[t]he discrimination against foreign commerce effected by Iowa's tax scheme is stark." (Br. at 4). Yet beyond belaboring the obvious—that the Iowa statute differentiates, for purposes of inclusion in the tax base, between domestic subsidiary dividends and foreign subsidiary dividends—neither Kraft nor its *amici* even attempt to show that discrimination or a burdening of foreign commerce result from the Iowa scheme. In other words, Kraft's claim that the Iowa statute violates the Foreign Commerce Clause fails at the outset because Kraft has not and cannot show that

[10] "[T]he tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States." *Container Corp.*, 463 U.S. at 188. Moreover, discrimination is unlikely because the Iowa system treats all unitary businesses alike. For this reason, the political process is available as "a safeguard against . . . abuse." *South Carolina State Highway Dep't v. Barnwell Bros.*, 303 U.S. 177, 187 (1938); *see also* Laurence Tribe, *American Constitutional Law* § 6-5 at 410 (2d ed. 1988).

the Iowa statute facially "discriminates" against foreign commerce.

B. The Iowa Statute Does Not Facially Discriminate Against Foreign Commerce Because It Does Not Facially Discriminate Against Unitary Businesses Whose Income Includes Foreign Dividends

The question whether a tax statute facially discriminates against foreign commerce of a unitary business depends upon the statute's treatment of the unitary business's tax obligation. *See Washington v. United States*, 460 U.S. 536, 545 (1983) (State's tax structure must be examined as a whole). In order to "establish a consistent and rational method of inquiry" the Court must examine "the practical effect of a challenged tax." *Mobil*, 445 U.S. at 443; *see also Maryland v. Louisiana*, 451 U.S. 725, 756 (1981). "[W]hen considering whether a tax is discriminatory, 'equality for the purposes of competition and the flow of commerce is measured in dollars and cents, not legal abstractions.'" *Armco, Inc. v. Hardesty*, 467 U.S. 638, 647 (1984) (Rehnquist, J., dissenting) (*quoting Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 70 (1963)).[11]

Kraft deliberately avoids this approach. Instead, it purports to demonstrate that the Iowa tax "discriminates" against foreign commerce solely because Iowa, in calculating the corporate tax base, differentiates (like the federal government) between dividends paid by a domestic corporation and dividends paid by a

[11] *See also Container Corp.*, 463 U.S. at 170-71 (under Commerce Clause, state tax might discriminate against interstate or foreign commerce if it produced double taxation of the same income "and *a resulting tax burden* higher than the taxpayer would incur if its business were limited to any one jurisdiction") (emphasis added).

foreign corporation operating outside the United States. The focal question that must be addressed in determining whether the Iowa statute discriminates against foreign commerce, however, is whether Iowa's income tax facially discriminates against unitary businesses whose income includes foreign dividends.

Iowa does not tax dividends separately, but only to the extent that they form one component of overall corporate income. It is not merely the dividends received by the parent in a unitary business, but "'the entire net income . . . generated by interstate as well as intrastate activities, [that] may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs.'" *Mobil*, 445 U.S. at 436 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959)). Insofar as Iowa taxes dividends from abroad received by a parent, it does so as part of the parent's unitary business income. *See Mobil*, 445 U.S. at 446. And while here, as in *Mobil*, "the State . . . include[s] [foreign] *dividends* from the subsidiaries to the parent in its calculation of the parent's apportionable taxable income," it very significantly does not include "the underlying income of the [foreign] subsidiaries themselves." *Container Corp.*, 463 U.S. at 169 n.7. Dividends obviously do not necessarily represent all of the foreign subsidiaries' earnings. "A corporation's decision as to how much of its earnings to pay out in dividends is subject to many variables. Nothing says that 100% must be passed through to the stockholders." *Mobil*, 445 U.S. at 460 n.18 (Stevens, J., dissenting). As a majority stockholder, Kraft largely can control the percentage of its subsidiaries' earnings that is paid out in dividends. *See id.*

Under the Iowa system, the earnings of foreign corporations doing business overseas become subject to tax by the United States (and by the States) only when paid as dividends to the domestic parent. Under this approach, the values that these foreign subsidiaries contribute to the unitary business are therefore never subject to apportionment unless they are paid to the parent as dividends. The underlying income of domestic subsidiaries in a unitary business, by contrast, is subject to apportionment. While the dividends that a subsidiary doing business in Iowa pays to its parent are not included in the parent's tax base, the subsidiary's earnings are themselves apportioned and subject to Iowa tax. For these reasons, from the standpoint of overall income, a unitary enterprise with an Iowa subsidiary—taxed on earnings, not dividends—is almost certain to bear a higher state tax burden than a business with a foreign subsidiary. This belies Kraft's assertion that Iowa's tax treatment of foreign dividends facially discriminates against foreign commerce.

When analyzed as a national system of state taxation, the Iowa scheme, far from discriminating against foreign commerce, actually gives much more favorable treatment to foreign than domestic subsidiaries. If we "hypothesize[] a situation where other States have passed an identical statute," *Goldberg v. Sweet*, 109 S. Ct. 582, 589 (1989), the result would be every State taxing its apportioned share of the entire operating income of domestic subsidiaries, but only taxing its apportioned share of the dividends that foreign subsidiaries actually pay—in all but the rarest cases, a smaller amount.[12]

[12] The Iowa approach is plainly far less inclusive than the California combined apportionment approach that was held in *Container Corp.* not to violate the Foreign Commerce Clause. *See* discussion *supra* at 6.

The fact that the application of a state tax is influenced in part by events outside the State "does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.'" *Mobil*, 445 U.S. at 437 (quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940)). This is true whether the net income is generated in other States or outside the United States. *See id.* at 438. There is nothing about the nature of foreign-derived dividend income that distinguishes it for state tax purposes from general operating income. *See id.* at 437-38. "[S]o long as the intrastate and extrastate activities form[] part of a single unitary business," *id.* at 438, apportionability cannot be challenged on the theory that the source of the income may be geographically ascertained. *See id.; see also Container Corp.*, 463 U.S. at 181.

Kraft's position is "based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." *Container Corp.*, 463 U.S. at 181. The foundation of the unitary business doctrine is that there is no single situs to which income that contributes value to a unitary business may be attributed—be it foreign dividends, a parent's own operational income, or the operational income of its domestic subsidiaries. *See Amerada Hess Corp.*, 490 U.S. at 74.

In taxing a unitary business, a State need not use geographical or transactional accounting merely be-

cause the taxpayer asserts that its income can be attributed to a specific location.

> [S]eparate accounting, while it purports to isolate portions of income received in various [locations], may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize income of the business as having a single identifiable "source" . . . .
>
> The Court has applied the same rationale to businesses operating both here and abroad.

Mobil, 445 U.S. at 438 (citation omitted). A parent corporation therefore may not treat dividends from its overseas operations as a species of value that is segregable from the earnings of its domestic operations:

> So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability. . . . Transforming . . . income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business. . . .

Id. at 440-41.[13]

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[13] The Court is currently reexamining whether functional integration is a prerequisite for finding the existence of a unitary business. *See Allied-Signal, Inc. v. Director, Division of Taxation*, No. 91-615 (reargument scheduled for April 22, 1992). Kraft, however, concedes that its business is unitary. Pet. App. 33a, 55a.

In short, while the Iowa tax system, like the federal system, differentiates between foreign and domestic *dividends*, it does not facially discriminate against foreign-derived *income* and does not violate the Foreign Commerce Clause. Because Iowa and other States apportion and tax the earnings of the domestic subsidiary corporations from which dividends are paid, the state tax burden of a unitary business with domestic subsidiaries will most likely be greater than the tax burden on a unitary business with foreign subsidiaries. It makes no difference if a State taxes unitary income based upon subsidiary dividends in some instances and subsidiary earnings in others. The crucial question is whether the whole of the unitary business is subjected to a higher income tax burden, and the answer to that question does not depend upon the formal labels affixed to the income. As the Solicitor General pointed out in his *amicus* brief at the petition stage (p. 9):

> While the Iowa scheme, like the federal scheme, 'facially' . . . differentiates between [domestic and foreign] . . . dividends, that does not necessarily imply that the total income stream of a foreign subsidiary is subjected by Iowa to a greater or lesser total tax burden than that of a domestic subsidiary of the same unitary enterprise.

Because Kraft cannot demonstrate that Iowa's taxing scheme on its face subjects foreign commerce to a discriminatory burden, its facial challenge to the Iowa tax must fail.

II. THE IOWA TAX STATUTE DOES NOT VIOLATE THE FOREIGN COMMERCE CLAUSE BECAUSE IT DOES NOT DISCRIMINATE IN FAVOR OF IN-STATE BUSINESS

Even if Kraft may validly focus this case solely on Iowa's tax treatment of dividends, and even if the Court concludes that the differentiation in the Iowa statute treats foreign-source income less favorably than domestic-source income, this differential treatment does not violate the Foreign Commerce Clause. The Iowa Supreme Court was correct in holding that "[i]n the commerce-clause challenge here . . . Kraft must show, as in the case of alleged interstate discrimination, that Iowa businesses receive a commercial advantage over foreign commerce due to Iowa's taxing scheme." Pet. App. 7a. Invoking the Foreign Commerce Clause does not alter the meaning of "discrimination" under *Complete Auto* and subsequent cases: whether the state legislation is "designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy Co. v. Limbach*, 486 U.S. 269, 273 (1988); *see also Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270-73 (1984).

Discrimination against interstate commerce implicates two related concerns. The Interstate Commerce Clause not only ensures Congress's power to regulate, but also affirmatively protects the citizens of one State from discriminatory actions taken by the legislature of another. "A discriminating tax imposed by a State operating to the disadvantage of . . . [another] State, is, in effect, a regulation in restraint of commerce among the States, and as such is a usurpation of the power conferred by the Constitution upon the Congress of the United States." *Walling v. Michigan*, 116 U.S. 446, 455 (1886). The Interstate Commerce

Clause "creates an area of free trade among the several States," *see Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 402 (1984), and prevents States from injuring one another through a "multiplication of preferential trade areas." *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 356 (1951); *see also Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979) (Interstate Commerce Clause prevents "economic Balkanization" among the States); *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944) (Commerce Clause establishes "an area of free trade" among the States by forbidding them to impose barriers against each other's products and trade).

When discrimination in favor of domestic commerce over foreign commerce is alleged, the same concerns are implicated. It therefore makes no sense to argue that an additional purpose of the Foreign Commerce Clause is affirmatively to protect the trade of foreign countries and that there is a different test for "discrimination" merely because the Foreign Commerce Clause is invoked. Yet these erroneous premises are the essential underpinning of Kraft's argument that a state tax is invalid whenever it can be shown to disadvantage foreign commerce in favor of domestic commerce.

The pertinent constitutional materials amply support the settled understanding of the Interstate Commerce Clause, but offer no basis for Kraft's novel construction of the Foreign Commerce Clause. With respect to interstate commerce, Hamilton noted that "[a]n unrestrained intercourse between the States themselves will advance the trade of each by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but for ex-

portation to foreign markets." *The Federalist* No. 11, at 132 (Hamilton) (Isaac Kramnick ed., 1987). On the other hand, lack of federal control of commerce between the States would lead to such "conflicts of State regulations that the citizens of each would at length come to be considered and treated by the others in no better light than that of foreigners and aliens." *Id.* No. 22, at 178 (Hamilton). The Framers sought to prevent those "regulations of trade by which particular States might endeavor to secure exclusive benefits to their own citizens." *Id.* No. 7, at 111 (Hamilton).

The purpose of the Foreign Commerce Clause was different. By 1787, the lack of federal power to regulate foreign commerce had "already operated as a bar to the formation of beneficial treaties with foreign powers." *Id.* No. 22, at 177 (Hamilton). Other countries feared dealing with a government in which "engagements on the part of the Union might at any moment be violated by its members." *Id.* No single State was powerful enough to maintain a favorable trading policy on its own. *See id.* The purpose of the Foreign Commerce Clause, therefore, was to unite and strengthen all of domestic commerce as against that of other countries. *See, e.g., id.* No. 11, at 129 (Hamilton) ("By prohibitory regulations, extending at the same time throughout the States, we may oblige foreign countries to bid against each other for the privileges of our markets.").

The two decisions upon which Kraft rests its argument, *Cook v. Pennsylvania*, 97 U.S. 566 (1878), and *Hale v. Bimco Trading, Inc.*, 306 U.S. 375 (1939), likewise fail to support it. According to Kraft, *Cook* establishes that under the Commerce

Clause no showing of in-state advantage is necessary before holding a statute unconstitutional. *See* Pet. Br. 19. But *Cook* is essentially an Import-Export Clause case. Applying that clause, *Cook* found a Pennsylvania tax "void as laying a duty on imports." 97 U.S. at 573. Since the Import-Export Clause expressly prohibits the States from "lay[ing] any Imposts or Duties on Imports or Exports," U.S. Const. art. I, § 10, a State violates that prohibition whether the duty it imposes on an import protects local industry or not.

In *Hale*, Florida's intent to discriminate to protect the Florida market—not just domestic commerce generally—was painfully apparent. The State justified its tax on foreign cement by express statutory reference to "the competitive effect of foreign cement in the Florida market," a reference which Justice Frankfurter found to be "a candid admission that the very purpose of the statute is to keep out foreign goods." 306 U.S. at 380. The Court, not surprisingly, described this explicit effort to protect the Florida market as an "assumption of national powers by a state . . . in collision with the Constitution." *Id.*

When a State is alleged to have favored domestic commerce over foreign commerce through its tax laws, the international double taxation and "speaking with one voice" tests of *Japan Line* suffice to determine whether it has violated the Foreign Commerce Clause. Leaving aside the issue of multiple taxation, which is not presented here, the state action is either consistent with federal policy, or it is not. But state legislation that favors in-state businesses over foreign business, like that of *Hale*, is more likely to interfere with congressional prerogatives. In addi-

tion, to the extent that a State favors its own commerce over that of other countries, it may also be giving an unfair advantage to its own commerce over that of other States. As *Hale* again illustrates, to the extent that Florida cement was relieved of having to compete against foreign cement in the Florida market, it gained an advantage over the products of other States not benefiting from similar home state protectionism.

The Iowa tax scheme is fundamentally different from the taxes challenged in *Cook* and *Hale*. By incorporating the federal government's treatment of foreign dividends, Iowa is manifestly not assuming national powers—it is acting consistently with national policy.[14] For it would, the Court has recently held,

> turn dormant Commerce Clause analysis entirely upside down to apply it to where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow. For the dormant Commerce Clause, in both its interstate and foreign incarnations, only operates where the Federal Government has not spoken to ensure that the essential attributes of nationhood will not be jeopardized by States acting as independent economic actors.

Wardair Canada, Inc. v. Florida Department of Revenue, 477 U.S. 1, 12 (1986).

Given the clear federal preference for Iowa's treatment of foreign dividends, Kraft's contention that the Iowa tax is somehow an "assumption of national powers" is especially unpersuasive.[15] As Justice Powell observed in *Container Corp.*, one way for a State to avoid Foreign Commerce Clause problems is to "base its apportionment calculations" of the income of a corporation receiving dividends from foreign subsidiaries on the corporation's "United States income as reported on its federal return." *Container Corp.*, 463 U.S. at 199 n.1 (Powell, J., dissenting). That is precisely what Iowa has done.[16]

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[14] Iowa and federal treatment of foreign dividends, while very similar, is not identical. Iowa does not replicate federal tax law when the corporate parent elects to take a tax credit under 26 U.S.C. §§ 901-902. But "[a]bsent some explicit directive from Congress, [the Court] cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States." *Mobil*, 445 U.S. at 448.

Moreover, Iowa's decision not to offer such a tax credit is totally consistent with federal tax policy. "[O]nce the Federal Government has allowed a credit for foreign taxes on a particular intercorporate dividend, we are not persuaded why, as a logical matter, a State would have to grant another credit of its own, since the federal credit would have already vindicated the goal of not subjecting the taxpayer to a higher tax burden that it would have to bear if its subsidiary's income were not taxed abroad." *Container Corp.*, 463 U.S. at 191 n.30.

[15] In *Container Corp.*, which upheld a state corporate tax scheme that was not patterned after federal law, the Court noted that the "Federal Government to the degree it has spoken, seems to prefer" the treatment of foreign dividends that Iowa employs here. *See Container Corp.*, 463 U.S. at 187; *see also id.* at 198 n.1, 201 (Powell, J., dissenting).

The federal government has unequivocally spoken in this case, of course, by filing a brief in support of Iowa.

[16] For the reasons set forth in the opinion of the Iowa Supreme Court, *see* Pet. App. 8a-10a, and the brief of respondent Iowa Department of Revenue and Finance, *amici* submit that the Iowa tax scheme does not violate the Equal Protection Clause.

CONCLUSION

The judgment of the Iowa Supreme Court should be affirmed.

Respectfully submitted,

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